

Creative Strategies for Using Your Home Equity

More and more Baby Boomers, with homes that have escalated in value, have contemplated using cash flow from their home equity as a way to lower debt and increase their investment account values. With at least \$1.1 trillion in Adjustable Rate Mortgages (ARMs) due to reset in 2007, according to The Mortgage Bankers Association, many boomers will consider refinancing. Another important decision boomers are going to have to make is how to use the cash flow from refinancing. Many may choose to use it as a way to manage their debt or increase their value in investment accounts such as a retirement account. Whatever strategy is chosen, it's important to understand that there are risks involved, especially given the decline in home values that began in many areas of the country in 2006. While in some situations home equity may help complement IRAs or other savings vehicles, it generally should not be relied on as your sole retirement asset.

Options for Homeowners

If you do have considerable home equity and are considering refinancing, strategies for tapping it may include downsizing to a smaller house or condominium, relocating to an area where the

cost of living is more affordable, and taking out a reverse mortgage. Regardless of which strategy you choose, it's important to be realistic about what your house may be worth, and if you opt to sell it, how long that may take when you retire. For instance, as of November 2006, the inventory of unsold homes on the market had reached a level that would take more than seven months for the market to absorb.¹ This data, from the National Association of Realtors, is a national average and homeowners in certain markets might have to wait even longer before making a move.

Consider Your Lifestyle

Selling your existing home may be a reasonable option if a move won't negatively affect your lifestyle. As part of your research, remember to investigate the overall housing costs in your desired area. And don't forget about the cost of moving. Downsizing may only make sense economically if you have enough home equity to leave you with a significant sum after paying closing and moving costs, making repairs to your new dwelling and buying new furniture or other enhancements.

Finally, when selling your home, consider that the first \$250,000 in capital gains (\$500,000 if you sell jointly with a spouse) is not subject to federal taxation if you lived in the house for two years or more.

Building a Retirement Portfolio

Many homeowners simply are not comfortable with the notion of selling or mortgaging their residence to amass a nest egg. If you share this view, remember that there are investment vehicles such as traditional IRAs and Roth IRAs that were established specifically for this purpose.² For the 2006 and 2007 tax years, you may contribute a maximum of \$4,000 to either type of IRA. If you are age 50 or older, consider making an additional catch-up contribution of \$1,000. Your 2006 contribution may be made any time until April 17, 2007; for 2007 you have until April 15, 2008.

When funding an IRA, you typically can select from a wide variety of investments to suit your risk tolerance and time horizon. Stock funds historically have generated higher long-term returns than bond funds but may experience ups and downs in the short term.³ To balance this short-term volatility, you may want to consider owning some bond funds, which historically have been more stable. Your precise mix of stock funds

and bond funds typically depends on your risk tolerance and time horizon — if you expect to remain invested for a decade or more, you may be able to ride out the short-term volatility of stocks. A shorter time horizon may mean more bonds with the goal of preserving your principal.

Home equity may complement traditional retirement vehicles such as an IRA but should not replace them. Spreading your risk among several different types of assets may increase the chances that if one declines in value, others may increase or hold steady and keep you on the road to a secure retirement.

This article is not intended to provide specific investment or tax advice for any individual. Consult me, your financial advisor, or your tax advisor with questions

¹Source: National Association of Realtors, January 4, 2007.

²Early withdrawals before age 59½ may be subject to a penalty tax.

³Sources: Standard & Poor's; the Federal Reserve. Stock returns are represented by the total return of the S&P 500, bonds by long-term Treasuries (10+ years). Performance is for the 30-year period ended December 31, 2006. Past performance does not guarantee future results, and investors cannot invest directly in any index.

Lump sum proceeds from mortgage services related transactions may not be used for the purpose of investing in securities offered through Linsco/Private Ledger.

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